

Persons who permanently affix tangible personal property to real estate, thereby making improvements to real estate, are considered to be construction contractors. In Illinois, construction contractors are deemed to be the users of the items that they permanently affix to realty and owe Use Tax on the cost price of the tangible personal property that they so affix to real estate. See 86 Ill. Adm. Code 130.2075. (This is a GIL.)

February 4, 1999

Dear Ms. Xxxxx:

This letter is in response to your letter dated November 2, 1998. The nature of your letter and the information you have provided require that we respond with a General Information Letter which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c), enclosed.

In your letter, you have stated and made inquiry as follows:

On behalf of our client's business operations, we would like to request a written opinion in regard to the following fact pattern and related taxability issues:

<i>Fact Pattern</i>

Taxpayer A is a manufacturer and distributor of refrigeration equipment, parts and installation services. Equipment and parts can be sold separately as tangible personal property or on an installed basis. The following issues pertain to sales and services occurring in your state.

<i>Issue #1 (EQUIPMENT SALES & INSTALLATION)</i>
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Customer X contracts with Taxpayer A for the purchase and installation of refrigeration equipment. Customer X is building a new facility (i.e. supermarket, convenience store, etc.) and/or remodeling an existing facility. The following types of refrigeration equipment will be supplied and installed by Taxpayer A:

A:

Walk-In Refrigerator and Walk-In Freezer

This equipment consists of pre-constructed 4' x 8' or 4' x 10' panels that are delivered to the construction site. A ceiling mounted cooling unit is hung to the inside of the assembled refrigerator or freezer. Pre-run copper lines and electric power lines are then connected to the refrigeration unit(s). Drain lines are run from the cooling and freezing units in tubes through the refrigerator and building walls to a drain location.

The refrigeration lines are run through copper tubing and can be prepiped into the building and secured to the building walls. The lines are then run through the building walls or roof to the exterior location of the compressor units.

Upright Reach-In Display Freezers/3 & 4 Door Models

This equipment is generally delivered to the construction site pre-assembled. Within the facility, the units are placed upon specially constructed 2' x 6' bases which are secured to the floor with silicone and cove base molding trim. Copper tubing for the refrigeration lines is run from the freezer to the refrigeration compressors which are generally located behind the store. in the attic or on the roof. The refrigeration and electrical wiring lines are run in copper and steel conduits attached to the interior of the building, through the walls or roof, from the display case to the refrigeration compressor units.

Open Dairy & Open Produce Cases

This equipment is generally 8' long, 42" deep and 7' high. The equipment is bolted to the facility floor to form a continuous line (i.e. wall). Refrigeration, electrical and drain lines are run similar to the freezer equipment described above.

Deli Case

Deli cases are placed and sealed to the building floor. The cases are hard wired to an electrical panel. The wiring panel normally comes from underground and then is secured to the deli case or building walls. The drain line is generally run from the equipment to a floor drain.

Condiment Shelf

This equipment is a stainless steel shelf secured to the building wall with screws and anchor bolts to hold the weight of various product items.

Hot Food Table

This equipment is hard wired to an electrical supply source or electrical panel supplying 230 volt power to the entire building.

- a. Does the above described equipment qualify as 'real property' and/or a 'capital improvement' for sales/use tax purposes?
- b. If Taxpayer A is deemed to be a contractor, should equipment fabrication labor be included with the cost of the equipment materials for calculating use tax due by the contractor? Taxpayer A does self-construct some refrigeration equipment to be installed.

Please address the sales/use tax responsibilities for the following interactions by Taxpayer A with Customer X:

- c. Taxpayer A provides both the equipment and installation for Customer X. Taxpayer A bills Customer X a 'lump-sum' amount.
- d. Taxpayer A provides both the equipment and installation for Customer X. Taxpayer A bills Customer X a 'separated contract' amount. The equipment is billed on one invoice and the installation services are billed on a separate invoice. Customer X has the option when purchasing the equipment to contract with Taxpayer A for the installation services or to contract with a third-party installer unrelated to Taxpayer A. In this situation, Customer X elected to utilize Taxpayer A for both furnishing and installing the equipment.
- e. Taxpayer A sells the equipment to Customer X to be installed by Customer X employees or a non-related third-party installation company.

Issue #2 (WARRANTY AGREEMENTS - RETAIL EQUIPMENT, PARTS & SERVICE)
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Taxpayer A has the following types of Warranty situations. Please address the sales & use tax applicability of the warranty agreement, parts and labor for each situation.

- 1. **General Equipment and/or Installation** Warranty - Taxpayer A provides customers with parts and services for a specified time period for no additional charge. This warranty is a *component* of the original equipment sale (i.e. generally a one-year time period). When a customer calls with a problem, Taxpayer A provides the required parts and/or service labor for no additional charge to the customer. Taxpayer A generally withdraws the required warranty parts from inventory or requisitions the parts from the manufacturer. The service labor is provided either by Taxpayer A service employees or subcontracted out to a third-party service company.
- 2. **Extended Equipment** Warranty - Taxpayer A sells Extended Warranties to customers. These warranties apply to periods and/or parts or services not covered through the terms of the *general* warranty. The customers are charged a separate lump-sum amount for the extended warranty. Extended warranties may be sold as a separate invoice line item in conjunction with the sale of equipment, or sold subsequent to the sale of the equipment. When a customer calls with a problem, Taxpayer A provides the required parts and/or service labor for no additional charge to the customer. Taxpayer A generally withdraws the required warranty parts from inventory or requisitions the parts from the manufacturer. The service labor is provided either by Taxpayer A service employees or subcontracted out to a third-party service company.

3. *Extended Installation Warranty* - Taxpayer A sells Extended Warranties to customers. These warranties apply to periods and/or services not covered through the terms of the *general warranty*. The customers are charged a separate lump-sum amount for the extended warranty. Extended warranties may be sold as a separate invoice line item in conjunction with the sale of installation services or sold subsequent to the sale of the installation services. When a customer calls with a problem, Taxpayer A provides the required materials and/or service labor for no additional charge to the customer. Taxpayer A purchases or withdraws from inventory any installation materials (i.e. wiring, piping, etc.). The service labor is provided either by Taxpayer A service employees or subcontracted out to a third-party service company.

Issue #3 (SALES TO GOVERNMENT, CHARITABLE, & NONPROFIT ENTITIES)
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1. Does your state tax sales made ***directly*** to government (i.e. federal, state, local), charitable (hospital, school, etc.), or non-profit (i.e. chamber, etc.) entities? If no, what type of exemption documentation is required from the exempt entity?
2. Does your state tax sales made ***indirectly*** (i.e. through contractors) to government (i.e. federal, state, local), charitable (hospital, school, etc.), or non-profit (i.e. chamber, etc.) entities? If no, what type of exemption documentation is required from the contractor and/or exempt entity?

Issue #4 (FREIGHT, SHIPPING & TRANSPORTATION CHARGES)

1. Does your state tax 'inbound freight' amounts separately stated on customer invoices?
2. Does your state tax 'outbound freight' amounts separately stated on customer invoices? Does it make a difference if the customer arranges for the freight and the freight company bills Taxpayer A and Taxpayer A bills the amount (no-markup) to the customer?

Issue #5 (TRAVEL & LIVING EXPENSES)

When Taxpayer A provides and installs refrigeration for a new facility, Taxpayer A's installation employees often incur travel and living expenses due to the location and/or length of the job. Are separately stated (on the invoice) travel and living expenses subject to sales or use tax?

Issue #6 (DEPOSITS & PROGRESS PAYMENTS)

On the basis that Taxpayer A's equipment and installation sales are generally large dollar amounts, Taxpayer A often requests deposits or progress payments. Is sales tax applicable upon *receipt* by Taxpayer of a deposit or progress payment or at the time of final billing to the customer?

Issue #7 (STORAGE AND TRANSPORTATION CHARGES)

Taxpayer A sells large equipment which is often customized (i.e. size, color, etc.) for a specific customer's facility. Taxpayer A is provided with a delivery date by the customer when the original sale order is placed. Taxpayer A manufacturer's the equipment and schedules the equipment for delivery. On occasion, the customer will contact Taxpayer A close to the delivery date and delay the delivery due to an unexpected construction delay. The customer generally provides a request that the equipment be placed in a storage facility until the site is prepared for delivery and installation. The customer may select the storage facility or the customer may ask Taxpayer A to select a storage facility. The storage facility generally bills Taxpayer A for the storage fee and any subsequent delivery amount. Taxpayer A bills the customer the actual amount (i.e. no markup) on a separate invoice. Subsequent storage and delivery charges are *not* a component of the original sale of the equipment or installation. Taxpayer A is not in the business of selling storage services or arrangements. Taxpayer A merely provides this assistance upon request by the customer for customer relationship purposes. Are the above described storage and/or subsequent delivery (pass-through) charges subject to sales tax?

We appreciate your assistance with this request. In addition to responding in writing to each of the above issues, please also provide any technical bulletins, statutes and regulations, etc. which you feel would be helpful. Do not hesitate to contact me at ####, for additional information.

Illinois taxes the retail sale and use of tangible personal property under two separate but related statutes. The Retailers' Occupation Tax Act imposes a tax upon persons engaged in the business of selling at retail tangible personal property. 35 ILCS 120/2 (1996 State Bar Edition). The Use Tax Act imposes a tax upon the privilege of using in this State tangible personal property purchased at retail from a retailer. 35 ILCS 105/3 (1996 State Bar Edition).

Persons who contract to permanently affix tangible personal property to real estate, thereby making improvements to real estate, are considered to be construction contractors. In Illinois, construction contractors are deemed to be the users of the items that they permanently affix to realty and owe Use Tax on the cost price of the tangible personal property that they so affix to real estate. See the enclosed copy of 86 Ill. Adm. Code 130.2075. If purchases are made from Illinois registered suppliers, the tax is to be paid to those suppliers at the rates in effect at the suppliers' location. If purchases are made from out-of-State suppliers not registered to collect Illinois tax, contractors must self-assess this tax and remit it to the Department.

Please note that if contractors make "over-the-counter" sales of items that are not permanently attached to real estate, they act as retailers. Such sales are subject to the Retailers' Occupation Tax based upon their selling price. If contractors buy parts that they will sell "over-the-counter," they may purchase such parts tax-free by providing suppliers with Certificates of Resale. See 86 Ill. Adm. Code 130.1405, enclosed, which describes the requirements for Certificates of Resale.

The taxability of service contracts or maintenance agreements depends upon if the charges for those agreements are included in the selling prices of the tangible personal property. If such charges are included in the selling price, those charges are part of the gross receipts of the retail transactions and are subject to tax. If this is the case, no tax is incurred on the maintenance services or parts when the repairs or servicing is performed.

Alternatively, persons may sell service contracts or maintenance agreements as separate agreements for predetermined fees. In these transactions, the proceeds from the sale of such contracts or agreements are not subject to tax. However, servicemen who provide service under the separate maintenance agreements or service contracts incur Use Tax liability based upon their cost price of the tangible personal property transferred incident to the completion of the maintenance agreements. See the enclosed copy of 86 Ill. Adm. Code 140.301(3)(b). Further, the purchaser of the separate agreement or warranty is not charged tax on the labor or tangible personal property that is transferred incident to the completion of the maintenance agreement. If a deductible is charged to the purchaser under the terms of the separate agreement, the deductible is also not subject to tax.

In Illinois, organizations that are determined by the Department to be exclusively charitable, religious, educational, or a governmental body, are issued tax exemption identification numbers ("E" numbers). Organizations holding such numbers are exempted from paying sales tax on organizational purchases. The organization must obtain and present this number to a retailer before it can make a tax-free purchase. Suppliers selling tangible personal property to such exempt organizations must retain the "E" number in order to document the exempt sale.

As stated above, contractors are generally considered to be the end users of tangible personal property that they permanently incorporate into real estate and owe Use Tax upon their purchases. However, contractors who physically incorporate tangible personal property into real estate owned by holders of "E" numbers can purchase such property tax-free by providing their suppliers with the certification described in Section 130.2075(d), as well as the "E" number of the group into whose real estate that property will be incorporated. The suppliers should retain this information in order to document the tax-exempt sale.

In general, shipping and handling or delivery charges are includable in the gross receipts subject to tax unless the buyer and seller agree upon such charges separately from the selling price of the tangible personal property which is sold. In addition, such charges must be reflective of the costs of shipping and delivery. To the extent that these charges exceed the costs of shipping, they are subject to tax. See 86 Ill. Adm. Code 130.415, enclosed. As a technical proposition, handling charges represent a retailer's cost of doing business, and are consequently always includable in gross charges subject to tax. See the enclosed copy of 86 Ill. Adm. Code 130.410. However, when such charges are stated in combination with shipping charges, they will be nontaxable to the extent the above tests are met.

The best evidence that shipping and handling or freight charges have been contracted for separately from the selling price is a separate contract for shipping and handling or freight charges. A separate listing of freight charges on an invoice, by itself, is insufficient. However, documentation that demonstrates that purchasers had the option of taking delivery of the property, at the sellers' location for the agreed purchase price, or having delivery made

by the seller for the agreed purchase price, plus an ascertained or ascertainable delivery charge, will suffice.

Please find enclosed a copy of 86 Ill. Adm. Code 130.430, which is the regulation related to Deposit or Prepayment on Purchase Price. Please note that any payment on the purchase price must be reported in gross receipts for Illinois sales tax purposes when the item that is being sold has been identified to a contract under the standards set forth in Section 2-501 of the Uniform Commercial Code, 810 ILCS 5/2-501 (1996 State Bar Edition).

Section 2-501 provides, in part, that, "identification can be made at any time and in any manner explicitly agreed to by the parties. In the absence of explicit agreement identification occurs (a) when the contract is made if it is for the sale of goods already existing and identified; (b) if the contract is for the sale of future goods other than those described in paragraph (c), when goods are shipped, marked or otherwise designated by the seller as goods to which the contract refers; (c) when the crops are planted or otherwise become growing crops or the young are conceived if the contract is for the sale of unborn young to be born within 12 months after contracting or for the sale of crops to be harvested within 12 months or the next normal harvest season after contracting whichever is longer."

As stated above, the Retailers' Occupation Tax Act imposes a tax upon persons engaged in the business of selling at retail tangible personal property. Therefore, in general, travel and living expenses and storage charges are not subject to the Retailers' Occupation Tax.

I hope this information is helpful. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Very truly yours,

Gina Roccaforte
Associate Counsel

GR:msk
Enc.